THE HARRIMAN INSTITUTE

FORUM

Volume 1, Number 8 *August, 1988*

The Foreign Economic Factor in *Perestroika*

by Ed A. Hewett

Of the many ways in which Mikhail Gorbachev differs from his predecessors, surely one of the most striking is his instinct to think and act internationally. The sullen, uncompromising, and often unsavory USSR of Brezhnev has been quickly supplanted by a more flexible and reasonable Soviet Union, inclined to interact with the rest of the world in ways unthinkable a few years ago. This "new thinking" has already brought changes in the substance as well as the form of Soviet policy, the result being that the USSR's role in global affairs has begun to change, as has its image.

Gorbachev's international orientation may be nowhere more apparent than in his approach to the economy. Currently most Soviet manufactured goods are sufficiently outmoded or poorly made that they are unsalable in the West. They can only be sold in the USSR because domestic industry enjoys total protection from foreign competition. Gorbachev believes *perestroika* will radically change that situation, and that by the early 1990s the USSR will be selling on world markets a broad range of manufactured goods on the leading edge of the world technological frontier.

Gorbachev's reasons for embracing such a demanding test for the success of *perestroika* are many. He believes the Soviet economy is capable of producing world-level technologies; Soviet weapons, and even some civilian products, attest to that capability. The problem lies in the economic system itself and in particular in the economic bureaucracy: the State Planning Committee (Gosplan); other bodies overseeing finance, pricing, and material-technical supply; and in the almost fifty ministries in charge of enterprises and farms. This bureaucracy's efforts to micro-manage the economy has led to a preoccupation with quantities at the expense of the quality and spontaneity associated with rapid innovation.

In effect the system is an inadvertent, but very effective, conspiracy to suppress innovation — a recipe for economic decline at the end of the twentieth century. Gorbachev understands that, and he is using *glasnost'* to expose the weaknesses and failings of the system.

He also seems to understand, at least in general terms, that for the Soviet economy to become a serious participant in world markets for manufactured goods it will have to interact much more than heretofore with the industrialized economies. Economic isolation is costly. The Soviet economy is living proof of that. Increased integration can act as a stimulus to higher quality, higher efficiencies, and therefore higher growth.

Out of these concerns have emerged the first signs of a new foreign economic policy in the USSR. Its main features are well-publicized: economic reforms decentralizing decision-making in foreign trade, the legalization of joint ventures, a broad-based effort to join international economic organizations, and a new enthusiasm for studying and learning from experiences of other economies on global markets. The USSR is emerging from its self-constructed economic shell. For western industrialized countries, this move provides challenges and opportunities unanticipated just a few years ago.

At this early point in the reforms it is difficult to say with any confidence how the process will finally work out. But it is possible now to create a broad-brushed picture of the emerging strategy for dealing with the world economy, and to reach a preliminary judgment on its likely contribution to Gorbachev's goals. This essay focuses on those aspects of *perestroika* directly related to links between the Soviet and the world economies. The broader aspects of the economic reform are only brought in where they are directly relevant.

THE W. AVERELL HARRIMAN INSTITUTE FOR ADVANCED STUDY OF THE SOVIET UNION
COLUMBIA UNIVERSITY • 420 West 118th Street • 12th Floor • New York, New York 10027

The discussion will also be limited to changes in Soviet economic relations with the developed West. Soviet leaders have elaborated on measures to change the relationship with the East, but they have had little real impact so far.[1]

Legacies of the Past

The guiding principle in the USSR's management of foreign economic relations has been, and remains, what the Soviets refer to as the "monopoly of foreign trade" which in practice means that the state has total legal control over all foreign trade and financial transactions. In the mid-1980s, when Gorbachev assumed the post of General Secretary, the foreign trade monopoly was operating in much the same way it had since the 1930s. All the basic decisions on exports, imports, and financial flows (debt policy, gold sales) were made within the planning hierarchy, under the guidance of Gosplan. The implementation of those decisions was the job of the Ministry of Foreign Trade (MFT), which through its foreign trade organizations (FTOs) enjoyed generally exclusive rights to handle exports and/or imports for a selected range of products.

The FTOs bought and sold goods in foreign currency, in turn selling to or buying from Soviet enterprises in domestic currency at domestic prices. Soviet enterprises wishing to import a product had to apply to their ministry. If the ministry agreed, it negotiated with Gosplan. If Gosplan consented, then the enterprise, through its ministry, received the authorization to import a product, which it could only do through the appropriate FTO. Similarly, Soviet enterprises would be ordered to export a portion of their output; they would do so by selling it to the FTO for approximately the same price they would sell it to another Soviet factory, irrespective of the world market price. Soviet producers could buy or sell foreign goods without ever coming into contact with the foreign seller or purchaser.

The monopoly of foreign trade was, and is, one element of the state's monopoly over the right to set priorities in the use of the nation's resources. If the highest priority is plant and equipment for chemicals, energy, and the automobile industry, then that is where the foreign exchange is used, regardless of the tremendous pent-up demand in the population for imported consumer goods. If there were a market for foreign exchange where consumers could outbid producers for a portion of the foreign exchange pie, then the planners would have lost some control over that scarce resource.

In addition the state has historically used this system to shield the domestic economy from fluctuations in international markets. The ups and downs of world markets, reflected in prices and exchange rates, are absorbed by the state budget so that domestic enterprises neither reap the benefits nor pay the costs of world price changes. When world oil prices soared in the 1970s and early 1980s, oil prices inside the USSR remained essentially unchanged at the level set in 1967. In effect, the windfall losses and gains of dealing with the world economy have been "socialized," as one component of the economic security the system provides to the Soviet population.

Finally, Soviet planners have consistently used the monopoly to protect domestic producers from foreign competition. Soviet enterprises can be confident that if they produce a product, no matter how low its quality and how high its price relative to the qualities and prices of similar products on world markets, Soviet customers will be forced to buy the product or go without. Central planning, as it has been implemented in the USSR, is institutionalized protectionism. It is equivalent, in a market economy, of placing prohibitively high tariffs on the importation of every foreign commodity which is also produced by domestic enterprises.

This approach to managing foreign economic relations destroyed Soviet enterprises' interest in exports, for four reasons. First, domestic producers rarely met their foreign customers — since the FTOs handled that — and therefore they had little information on precisely what customers wanted. Second, the needs of foreign customers were not of great interest in any event since a Soviet factory received essentially the same price whether it shipped to Leningrad or Los Angeles. Third, since most products are in short supply on the Soviet market, producers had little difficulty in selling what they made domestically, eliminating the necessity of exports. Finally, even in those cases where the products were of such low quality that domestic demand fell short of output — some consumer durables, for example — the state made sure the firm did not go under.

All four of these conditions contributed to a lack of interest in exports, but especially the last two. With domestic demand so strong, there was little need to go to the extra trouble of developing exports, and in any event, the survival motive so important in the export efforts of many western firms was nonexistent because of automatic subsidies and bail-outs.

On the import side the Soviet user paid a fixed price which was generally quite low, either because he was paying the same price as for a domestic equivalent (which in fact was probably an inferior product), or because he was paying the actual import price converted at an overvalued exchange rate.[2] The result was an almost insatiable hunger for imports, which were a cheap, high-quality alternative to Soviet products.

1 For a discussion of the Gorbachev reforms and their background, see my *Reforming the Soviet Economy: Equality vs. Efficiency* (Washington: Brookings, 1988).

2 In the early 1980s Soviet imports tended to be priced at the actual foreign trade price multiplied by the official exchange rate, which averaged during that period about 75 kopecks/dollar. (Vladimir Treml and Barry Kostinsky, *Domestic Value of Soviet Foreign Trade: Exports and Imports in the 1972 Input-Output Table*, Foreign Economic Report 20 [U.S. Department of Commerce, 1982], 20-21.) An exchange rate which reflected the true cost to the USSR of earning a dollar, of the sort now used in most of Eastern Europe, might be closer to R2.50/dollar. On a $150,000 machine, the difference for a Soviet producer is between paying R100,000 at the official exchange rate or R375,000 at the more economically meaningful exchange rate.

The failings of this system were already evident to Soviet economists in the 1960s (East European economists, living in systems far more dependent on foreign trade than the USSR, had figured it out in the 1950s.) And in the late 1960s and early 1970s there were debates within the institutes and the government, mostly secret, on how to improve the system. The results were a series of minor measures which amounted to tinkering, leaving the basic system intact.[3] In the meantime most East European countries had moved ahead with reforms designed to decentralize some foreign trade rights and introduce exchange rates more closely approximating the scarcity of exchange in the country.[4] By the mid-1980s, the Soviet economy stood virtually alone in its stubborn adherence to a system which was obviously unable to cope with the tasks of managing trade and economic cooperation with the outside world.

The Gorbachev Reforms in Managing Foreign Economic Relations

Gorbachev brought into power many who had long advocated reforms in the management of Soviet foreign economic relations along the lines of the East European reforms of the 1960s and 1970s. These changes included introduction of a meaningful (probably devalued) exchange rate based on the real cost of earning a dollar, which in turn would permit a decentralization in decision-making power concerning exports and imports from the MFT to the enterprises actually engaged in trade, at the same time retaining strong central control over the general structure of imports. Many of the institutes were behind such an approach. Most notable were the directors and staffs of three of the most important Moscow-based institutes: the Institute for World Economy (under the direction of Oleg Bogomolov); the Institute for the Study of USA and Canada (Georgii Arbatov); and the Institute for World Economy and International Relations (Alexander Iakovlev, followed by Evgenii Primakov).

In the 1970s many in these institutions had fought for reforms in foreign trade, primarily through unpublicized debates with government officials. Gorbachev's accession to power in 1985 provided sufficient encouragement to renew their quest, leading to a new — again almost totally unpublicized — debate during 1985-86. By summer 1986 decrees reforming the system had been drafted in joint sessions between academics and government officials, under the general supervision of the reform commission formally supervised by Nikolai Talyzin (then chairman of Gosplan).[5] The decrees were approved in August 1986, and implemented beginning that Fall.[6] In January 1987, two companion decrees were published, one on joint ventures with socialist countries, another for joint ventures with developing and developed capitalist countries.[7] There were many signs that the decrees were drafted quickly, leaving ambiguities which required clarification. One of the consequences was the need in October 1987 to modify some of the original provisions in all four of the decrees.[8]

As with the remainder of Gorbachev's reforms, the approach in the foreign sector is to recentralize control over the basic operation of this portion of the economy, while increasing the power of lower levels to make decisions on those details of less importance to the center. The intention is to retain the monopoly of foreign trade, but to streamline the system in order to enhance incentives for Soviet enterprises to export manufactured goods.

The centerpiece of the centralizing side of the reform is the State Foreign Economic Commission, *Vneshneekonomicheskaia Gosudarstvenaia Kommissiia* (GVK) headed by Deputy Prime Minister Vladimir M. Kamentsev, with duties comparable to the other bodies managing complexes in the new system (the Machine building *biuro*, Gosagroprom, the State Construction Committee, and so on). The GVK has formal authority over all foreign economic relations, whatever organization may be involved.[9] GVK's job is to develop a foreign economic strategy, monitor and guide the reform process in this area, and control the planning and implementation of foreign economic operations throughout the system.[10]

The decentralizing side of the reform can be seen in the new rights granted to some enterprises and ministries to deal directly on foreign markets, rather than through MFT FTOs.

3 See Ed A. Hewett, "Foreign Economic Relations," in Abram Bergson and Herbert Levine (Eds.), *The Soviet Economy: Toward the Year 2000* (London: George Allen & Unwin, 1983), 269-310.

4 Hungary was the leader here. See Paul Marer, "Exchange Rates and Convertibility in Hungary's New Economic Mechanism," in U.S. Congress, Joint Economic Committee, East European Economic Assessment, Part I (Washington D.C.: Government Printing Office, 1981).

5 The *Komissiia po sovershenstvovaniiu upravleniia, planirovaniia i khoziaistvennogo mekhanizma* (Commission on the Improvement of the Management, Planning, and Economic Mechanism) was established under the Council of Ministers to oversee the drafting of all documents for the Gorbachev reforms via a set of 26 working groups bringing together government officials and academic specialists on the various components of the reform. For more details, see Hewett, *Reforming the Soviet Economy*, 324-5.

6 "O merakh po sovershenstvovaniiu upravleniia vneshneekonomicheskimi sviaziami," *Vneshniaia torgovlia*, no.3 (March 1987), insert, pp 1-4; and "O merakh po sovershenstvovaniiu upravleniia ekonomicheskim i nauchno-tekhnicheskim sotrudnichestvom s sotsialisticheskimi stranami," *Vneshniaia torgovlia*, no. 3 (March 1987), insert, pp. 4-8. The decrees were signed on August 19, but these, the fullest versions, were not published until the following March.

7 There are two separate decrees here, both issued on January 13, one covering joint ventures with Council of Mutual Economic Assistance (CMEA) countries, the other covering joint ventures with "capitalist and developing countries." Both can be found in "O sozdanii sovmestnykh predpriatii v SSSR," *Vneshniaia torgovlia*, no. 3 (March 1987), insert.

8 "O dopolnitel'nykh merakh po sovershenstvovaniiu vneshneekonomicheskoi deiatel'nosti v novykh usloviiakh khoziaistvovaniia," discussed in "V Tsentral'nom Komitete KPSS i Sovete Ministrov SSSR," *Ekonomicheskaia gazeta*, 41 (October 1987), 18-19.

9 Ministry of Foreign Trade, the State Committee for Foreign Economic Relations (the two were merged into the Ministry for Foreign Economic Relations in 1988), The Bank for Foreign Economic Relations (formerly the Foreign Trade Bank, reconstituted on January 1, 1988), Intourist, tariff authorities, and those foreign economic activities of all ministries and other authorities.

10 The first of the two August 19 decrees in footnote 6 gives the details for GVK. See also the interview with Kamentsev, "Sovershenstvovanie vneshneekonomicheskoi deiatel'nosti," *Ekonomicheskaia gazeta*, 3 (January 1987), 6-7.

Beginning in 1987 twenty-one ministries and ministerial-level bodies were given their own FTO's (primarily by disbanding the equivalent FTO's in the Ministry of Foreign Trade) and 68 enterprises were given their own foreign trade *firmy*.[11] By 1988 that figure had grown somewhat to 23 ministerial-level bodies and 80 enterprises, accounting for approximately 20% of foreign trade turnover. About 65% of the exports of machinery and equipment will be direct exports.[12] For example, up until 1986 Kamaz (the Kama Truck River Plant), a producer of heavy trucks based on equipment purchased primarily in the West, had to go through the FTO Avtoeksport for all of its export sales. Now Kamaz handles its own exports directly, and can retain for its own use a portion of the export proceeds.

Those funds can be used to import goods and services, the main restriction being that dollar accounts cannot be used to purchase consumer goods, but must be used for productive assets and materials.[13] Enterprises not authorized to engage in foreign trade can contract through an FTO and retain a portion of the currency they earn. For example, those truck and automobile enterprises without direct trading rights will now export through the Ministry of the Automobile Industry, which has taken over from the MFT all functions of the FTO Autoeksport not transferred directly to enterprises.[14]

These measures are openly designed to reduce the power of the Ministry of Foreign Trade, a point emphasized when the Ministry was formally "abolished" with only some of its staff retained in a new Ministry for Foreign Economic Relations (*Ministerstvo vneshneekonomicheskoi sviazi*, or MVES) formed out of a merger with the State Committee for Foreign Economic Relations (*Gosudarstvenni kommitet ekonomicheskogo sotrudnichestva*, or GKES).[15] The MVES retains approximately 30 FTOs carrying on trade in fuels, raw materials, food, machinery and equipment outside of that covered by ministries and enterprises with direct foreign trading rights.

The direct access of Soviet enterprises and ministries to foreign markets requires that they be able to convert domestic rubles into foreign currency, and vice versa. The obvious solution — a true exchange rate at which enterprises could convert their export proceeds into rubles and their rubles into foreign exchange — is precluded until the price reform (currently scheduled for 1989-90) changes what is now a crazy quilt-work of relative prices. At current prices, raw materials and fuels are cheap, machinery and equipment relatively expensive. At a single exchange rate enterprises guided by profit considerations would, quite inappropriately, try to export raw materials and fuels, while avoiding exports of manufactured goods.

Soviet authorities, anxious to go ahead with the foreign trade reform without waiting for the price reform, have come up with an interim solution involving special exchange rates for each of about 2,000 product groups. The machinery and equipment categories will generally have devalued exchange rates (say in the neighborhood of \$.50 - \$1.00 per ruble), while raw materials will have revalued exchange rates (say \$2.00 or more per ruble). The effect is to make a dollar's worth of machinery sales worth far more rubles than a dollar's worth of raw materials, thus counterbalancing the irrationalities of the unreformed price system. If the price reform is done correctly it will be possible to do away with these coefficients and introduce a unified exchange rate.[16]

How Radical is the Departure from the Past?

This decentralization is less dramatic than it may first appear. In the first place the government retains control through the MVES over all exports and virtually all the foreign exchange from fuels, raw materials, food, and (presumably) arms. In 1987 those categories constituted 87% of Soviet non-socialist exports.[17] That foreign exchange will be distributed through the ministerial system to enterprises as it has in the past, on the basis of bureaucratic bargaining.

Of the remaining Soviet non-socialist exports, enterprises will retain only a portion for their own use. The residual goes into state foreign exchange accounts. Even the retained foreign exchange may be fully spoken for. It is likely that planners have shifted to enterprises the responsibility to finance some imports hitherto financed from central foreign exchange funds. If so, this hard currency self-financing regime could leave some enterprises worse off than they were under the old system, if their retained foreign exchange falls short of funds for necessary imports previously financed from centrally-allocated funds.

The only way direct export and import rights could begin to make a positive difference is if Soviet manufacturers aggressively search out new export markets, then use their retained foreign exchange to buy imports. But Soviet enterprises are still so well protected from import and domestic competition that it will be a miracle if they decide to bypass easy opportunities to sell on domestic markets, and instead take on the infinitely harder task of carving out a market share

11 V. Shemiatenkov, "Perestroika vneshneekonomicheskoi deiatel'nosti," *Ekonomicheskaia gazeta*, 3 (January 1987), 6-7.
12 The 1988 numbers are from Ivan D. Ivanov, "Gosudarstvennaia monopoliia vneshnei torgovli: formy i problemy na 70-letnem rubezhe," *Vneshniaia torgovlia*, 4/88, 3; the proportions are from the interview with Kamentsev, *ibid.*
13 Enterprises dealing with CMEA countries can retain a portion of their transferable ruble (TR) proceeds, and those can be spent on any product, including consumer goods.
14 The magnitude of the retention coefficients is not known, but the general rule seems to be that they are quite small for unprocessed goods — say in the 5% range — rising with the degree of processing to a maximum of 70% for manufactured goods which are difficult to sell for hard currency.
15 The GKES has been a powerful committee managing, through its own FTOs, all foreign aid, including large construction projects abroad. Now those duties shift to a new ministry, whose head is Konstantin F. Katushev, former head of GKES.
16 I am considerably oversimplifying a very complex system which, in addition, has only been discussed in the most general terms in public documents. This account should be taken as no more than an indication of the general thrust of the coefficient system.
17 *PlanEcon Report*, Vol IV, 14, April 8, 1988, p. 2.

in the capricious and demanding world markets. In any event the 2000 product group-specific exchange rates were designed to make the existing export structure profitable, which hardly builds incentives to expand exports, or to develop new export products. Even for those enterprises which do enthusiastically pursue export opportunities and build up a reserve of hard currency, it remains to be seen whether planners will allow them to import whatever capital equipment and materials they may need.

In sum, the new system for managing foreign economic relations appears to be no more than a modest departure from the past, and one which certainly is no threat to the absolute monopoly the state enjoys over foreign transactions. If Soviet monetary and fiscal policies grew tougher, leading to a reduction in excess demand, or if Soviet import policy began to encourage competitive imports, then the new institutional system would take on a different meaning. Enterprises would suddenly have not only an incentive, but a need, to expand exports. But so far there are no signs of that new policy stance, which means that so far the changes are more in form than in substance.

Joint Ventures

The one potentially important departure from the past is in the new laws authorizing joint ventures with enterprises in capitalist and socialist countries. Joint ventures with capitalist countries are potentially the most revolutionary feature of the new system. Of the 36 joint venture agreements signed as of May 1987, 32 were with western companies.[18]

The new laws permit foreign investors to join one or more Soviet partners in establishing a new enterprise on Soviet soil, where the western ownership share can reach 49%. The January 1986 decree required USSR Council of Ministers approval for all joint ventures; the October 1986 modification, as part of a general reduction in red tape, allowed the ministries involved to give final approval, unless special exceptions (for example a special deal on profit repatriation) were part of the agreement. The Chairman of the Board and General Manager of the joint venture must be Soviet; but the agreement establishing the joint venture can specify certain types of decisions (new debt, major investments, etc.) which require consensus among the board members. The enterprise is not subject to control by the planning system. The enterprise, however, does not have access to centrally-allocated materials; it must deal through an FTO to acquire whatever materials it wishes to buy from the Soviet economy. It can import — for hard currency — without restriction, either using its own or borrowed funds, and it retains its hard currency export receipts.

Like other Soviet enterprises, joint ventures operate on a hard currency self-financing basis. All hard currency imports must be covered by hard currency exports. In addition, if the venture is profitable and a western partner wishes to convert his share of the profits into convertible currency, he can only do so if the venture has earned sufficient foreign exchange to cover all its hard currency imports, and the conversion. Thus a western company which is involved in a joint venture with exports of $1.5 million, but imports of $1.5 million, cannot — according to law — take even a dollar's worth of profits, no matter how high the ruble profits. The profits stay in rubles, either to be used for reinvestment, or to be retained until net export receipts are sufficiently large to support profit repatriation. This is the law, although there are possibilities to make special deals in situations where the Soviets want the project.[19]

A partially foreign-owned enterprise operating on Soviet soil outside the formal control of Soviet planners is a radical departure from past practice. However, as with the other reforms in the foreign sector, the real situation seems to have much more modest implications, at least for the near-term. Soviet authorities mainly see joint ventures as a way to increase exports, therefore they are holding firm in their requirement that profit expatriation can only be allowed if export proceeds are sufficient to cover it.[20] This precludes pure import-substituting joint ventures in which the Soviets use western technology and general know-how to produce for domestic use a product they would otherwise import. It also severely limits the interest of potential western partners whose primary motive is to profit from sales to the Soviet market, not to aid the Soviets in competing on western markets.

A second important consideration limiting the potential for joint ventures, particularly in manufacturing, is the fact that the Soviet economic system remains a centralized system in which enterprises must bargain for resources. Western partners to joint ventures will be dependent on their Soviet partners to bargain within the system for resources, not only in the right quantities, but also in the right qualities, and with timely delivery schedules. All of that could prove very difficult in a system where even defense industries experience delivery problems. It is doubtful that joint ventures will assume a higher priority than defense.

Soviet Approaches to International Economic Organizations

These new reforms in foreign economic relations have been accompanied by a vigorous effort to enhance the Soviets' influence and role in international economic or-

18 Interview material.
19 A significant number of the joint venture agreements already signed apparently involve special arrangements, the most typical being some sort of barter agreement where the western partner accepts Soviet products, not necessarily related to the joint venture, in lieu of profits, which he then sells somewhere in the West for dollars.
20 The exception of offering goods in barter is itself a form of forced export, and is totally consistent with the export goal.

ganizations. In part this is a natural consequence of "new thinking" in Soviet foreign policy. As the USSR seeks to broaden the foundations of its superpower status by strengthening its economic and political influence around the world, it will naturally attempt to harness the economy to that task. This will mean that the Ministry of Foreign Affairs (MFA) will take a more active role in foreign economic policy than in the past, as we saw, for example, when MFA representatives announced Soviet commitments to cut back their oil exports in 1986 and 1987 in a show of solidarity with OPEC.[21] It will mean that the USSR will want to be involved in the major international economic institutions which govern international trade and finance.

Membership in the General Agreement on Tariffs and Trade (GATT) has been, and continues to be, the highest Soviet priority in its new foreign economic policy. GATT is an agreement among market economies to actively pursue and protect liberal trade rules among themselves in order to promote free trade. It has been a powerful force in the postwar reductions in tariff barriers to trade, and an on-going venue for reductions of non-tariff restrictions on imports (quantitative restrictions, unnecessary quality requirements for imports, etc.). GATT membership will be important to the USSR if, and when, it develops a capacity to export manufactured goods competitive on world markets, since it will need to eliminate many tariff and non-tariff barriers targeted specifically on Soviet or East-Bloc products.

In late summer 1986 the Soviets sent what appeared to be a rather hastily composed letter to GATT asking to participate as an observer in the next round of trade talks beginning at Punta-Del-Este, Uruguay that fall. Their immediate concern was simply to get in on the beginning of what would be a long set of negotiations focusing on agricultural products, services, and non-tariff barriers.[22] GATT refused — due in part, but not solely, to U.S. objections — and the talks are going on without the Soviets.

The rejection seems to have reflected two major concerns on the part of western countries. First is the question of whether the Soviets would paralyze the organization — as they have at times with the UN and some of its subsidiaries — by pushing general propagandistic themes at the expense of serious business. A second issue is whether the Soviet reforms will be mostly words, not actions. If the traditional centrally planned economy remained intact, Soviet participation in GATT (built on the principles of free trade) or IMF (built on the premise of a convertible currency) would be meaningless.

That rejection has not deterred the Soviets, and they will probably reapply, possibly this year. In addition, they have moved ahead through the MFA and institutes involved in foreign affairs on a broad offensive designed to enhance the Soviet role in international and regional economic organizations.[23]

Sustained Soviet lobbying efforts in Japan brought the Soviets limited representation rights at the Pacific Economic Cooperation Council's (PECC) meetings in Ottawa in 1986 and Osaka in 1988.[24] A similar lobbying effort with the Asian Development Bank led to an invitation for a Soviet observer at its April 1987 meeting, and an invitation for several observers to the 1988 meeting in Manila.[25] Throughout 1987 the Soviets negotiated with the EEC over a bilateral agreement, and a roughly simultaneous conclusion of an EEC-CMEA agreement. The EEC-CMEA pact was signed in June, and discussions continue on the bilateral agreement.

Also in 1987 the Soviets announced, to the surprise of many, that they would join the Common Fund for Commodities, an effort sponsored by the United Nations Conference on Trade and Development (UNCTAD) to create funds to be used in stabilizing prices of key commodities. The Soviets, who had heretofore refused to join, blaming underdevelopment on the advanced capitalist countries, contributed approximately $29 million. Now the U.S. — whose contribution would be approximately $74 million — is the major holdout.[26] In a similar vein, the Soviets announced in the Fall of 1987 that they would pay $200 million in arrears to the U.N. for support of programs to which they had previously objected.

Soviet goals in this all-out effort to join international economic organizations are not yet totally clear. It is certain that GATT membership remains a high priority. The Soviets appear to be leaning towards the notion that, because of the reforms, they will be able to approach GATT as a market economy, in much the same way Hungary did in the early 1970s.[27] A tariff system is ready to be put in place after the new price reform. That would make it possible to offer most-favored nation (MFN) treatment for GATT members, without any special concessions — such as Romania and Poland gave when they joined in the 1970s — to compensate for the continued reliance on central planning, and the resulting protectionist consequences.

Whether this strategy will be followed remains to be seen. It would be miraculous if, in fact, Soviet reforms moved so quickly that it would be possible by any stretch of the imagination to declare in a few years that the USSR was in effect a market economy. But, assuming this is the approach the Soviets take, it will most likely be political reality, not the economic facts, which determine whether or not it will bring them into GATT.

21 Anders Aslund, "The New Soviet Policy Towards International Economic Organizations," *World Today*, February 1988, pp. 27-30.; and *Financial Times*, January 23, 1987, p. 34.
22 The letter has not been made public; this is based on interview material.
23 Unless otherwise indicated, this information is based on Anders Aslund, *Ibid*.
24 Masashi Nishihara, "Soviet Moves in Southeast Asia and the South Pacific," Japan-U.S. Joint Study on the Soviet Union, Second Workshop, Boston, November 7-8, 1987, p. 11.
25 On the 1987 meeting, see Aslund, *Ibid*., p. 29. The 1988 meeting is discussed in the *Wall Street Journal*, Monday, May 9, 1988.
26 *Wall Street Journal*, July 14, 1987, p. 53; and *Financial Times*, July 14, 1987, p. 32.
27 Interview material.

Eventually the Soviets are likely to approach the International Monetary Fund (IMF) and the World Bank for membership. The IMF is at the center of efforts to control international financial flows, exchange rates, and — since the late 1970s — to deal with the enormous debt problems arising out of the OPEC oil price shocks. Although the Soviets were part of the early post-war negotiations at Bretton Woods which led to the formation of the IMF, they ultimately pulled out of the discussions, and subsequently showed little interest in an organization mainly devoted to managing financial relations among capitalist countries. More recently the Soviets have eschewed any responsibility for the debt problem, and therefore any obligation to find a solution.

But now they wish to become major players in the world economy, and logically they know that means they should play a more prominent and constructive role in world financial affairs, which means they must develop some sort of relationship with the IMF. The official position of the Soviet government at this point is that it has a strong interest in reforming the world financial system to bring more stability to global currency markets, but that the IMF is an organization with many shortcomings and is therefore not the ideal venue for such a project. Rather they seek talks between Soviet and western experts on these issues.[28] Recently, in private meetings, some Soviet economists have gone much farther in discussing what they characterize as a "consensus," but not yet official policy, that until the USSR is closer to a convertible currency, IMF membership will make little sense.

Soviet economists emphasize that if they were to join the IMF they would advocate reforms to stabilize exchange rates, and the world financial system as a whole, by reducing considerably the bands within which exchange rates would be able to fluctuate. At the same time they would seek to replace the dollar with a "genuine" international currency. Finally, they would argue for a "democratization" of the IMF by eliminating the possibility of veto by any country, at the same time retaining the basic notion now governing IMF voting, that each country's votes should somehow be related to the size of its economy and its trade with the world economy.

This "democratization" notion hints at the broader agenda behind the Soviet effort to enhance its role in the world economy. It will be a long time before Soviet leaders can argue convincingly that the USSR's economic power entitles it to a major role in most important economic organizations, most notably the IMF. But they can argue that the USSR is a powerful representative of those on the outside who feel they have little influence over a world financial and trade system which in turn rules their lives. "Does it not seem to you," Mikhail Gorbachev asked a group of U.S. businessmen in Moscow this past April, "that the circle of people and countries who discuss the problems of the world economy and its future are so severely limited that it is not possible to develop a fully objective and just outcome?"[29]

Issues for the West

How should western governments respond to Soviet efforts to join international and regional economic organizations? In part the answer lies in how we understand Soviet priorities. Clearly Soviet representatives in GATT or the IMF would at least give lip-service to the plight of the debtors, of the less developed countries (LDC's) on the edges of the world trading and financial system. But it is not at all clear that this would be their central focus.

The Soviets themselves are major creditors to many LDC's, mostly for arms sales, and to Eastern Europe. And their interests as creditors are not that far from those of the IMF. It is fairly apparent, for example, that the Soviet and IMF approaches to Eastern Europe's debts, respectively in transferable rubles and dollars, are not so different. Both advocate austerity plus economic reforms.

Furthermore the Soviet reforms do have many market-type elements in them which, if pursued to their logical conclusion, would eventually lead to an economic system which could conceivably participate fully in all international economic organizations. Soviet leaders have lost faith in traditional central planning, and they are engaged in a search for a more viable system which relies more heavily than in the past on markets. With such an orientation it is more likely that Soviet representatives in international economic organizations would share, and seek to promote, the general goals of those organizations.

The issues for Western governments over the next few years will not be a simple black and white; rather they will retain the grey cast they have had since Gorbachev assumed the post of General Secretary. The Soviets will most likely come to GATT arguing that their reforms are working far better than they are. The trends might be in the right direction, but the Soviet arguments will, understandably, be outside the trends. Western leaders shall have to decide if and when trends in the right direction are enough.

The calculation will be a complicated one. Soviet membership in international organizations could contribute to a trade expansion benefiting western countries in need of new export markets. There may be political benefits deriving from a deeper Soviet involvement in addressing major world economic problems. The world might learn much more about the USSR from data and other information generated in the process of Soviet accession to the various organizations.

Yet, on the other side of the equation lie the potentially high costs of attempting to absorb such an enormous centrally planned economy into a set of institutions designed to coordinate trade and financial relations among market economies. And there is the distinct possibility that in the end political

28 V. Kamentsev, "Problemy vneshneekonomicheskoi deiatel'nosti," *Kommunist*, October 1987, p. 34.
29 "Po sluchaiu sobraniia ASTES," *Sotsialisticheskaia industriia*, April 15, 1988, p. 5.

motives will dominate Soviet participation in these organizations, adding a new disruptive component to organizations already under strain.

The Foreign Sector and Economic Reform

General Secretary Gorbachev and his advisors must already recognize that the fate of *perestroika* rests not on their membership in international organizations, but on the success of the reforms themselves. Membership in GATT will mean little if the USSR has few competitive exports; membership in the IMF will be difficult at best as long as the Soviet ruble remains inconvertible. If this economy is to meet the tests Gorbachev has set for it in producing and exporting world-class manufactured goods, then the key is reform, not diplomacy. The West cannot grant the USSR the position it covets as a major world economic power. The Soviets will have to earn it.

Ultimately, success on that scale will come when Soviet enterprises can compete with enterprises of the industrial world on Soviet markets or on world markets. And that cannot happen until Soviet enterprises are driven to export, either because domestic competition is so strong that some enterprises must either lay off workers or sell abroad, or because import competition is forcing them to develop new products to sell either at home or abroad. But that would require, in turn, that Gorbachev's domestic reforms work well and quickly. A flexible price system, linked to world prices through an exchange rate, is an absolute requirement. A tight monetary policy realized through a zero-subsidies rule for failing enterprises is needed to make them realize that their existence is at stake if they do not develop salable products for domestic or foreign consumption. The central planning system would have to be truly and completely dismantled for all but the most basic and critical products (energy, some raw materials, etc.) in order to give the system the flexibility, and enterprises the autonomy, to operate in fast-paced world markets.

These are but a few of the most important measures necessary to give substance to the stated aspirations of the Soviet leaders to make their country into a formidable economic force on world markets. So far the implementation of *perestroika* is far more timid and the actual measures far more ambiguous than would be necessary to meet these very demanding criteria. As a result, the changes in the administration of the foreign sector are of far more modest consequence than Soviet rhetoric would suggest. The potential is there for major changes. Only time will tell if the current radical proposals will be implemented, and even more radical reforms will be pursued, in order to realize that potential.

Ed A. Hewett is a Senior Fellow at the Brookings Institution in Washington D.C., and the editor of the journal Soviet Economy. *He is the author of numerous books and articles on the Soviet and East European economies. His most recent book, published by Brookings in 1988, is entitled* Reforming the Soviet Economy: Equality vs. Efficiency.

The Harriman Institute Forum is published monthly by
The W. Averell Harriman Institute for Advanced Study of the Soviet Union, Columbia University
Editor: Paul Lerner
Editorial Assistants: Robert Monyak, Rachel Denber

ISSN Number: 0896-114X
Subscription information: In the United States or Canada by first class mail: $20 per year for individuals, $30 per year for institutions and businesses. Outside the United States and Canada by airmail: $30 per year for individuals, $40 per year for institutions and businesses.
Make check or money order payable to Columbia University and send to *Forum*, The Harriman Institute, Columbia University, 420 West 118th Street, New York NY 10027.
Back issues available (except Number 1) at $2 apiece.
Bulk orders available by request.